

ACTION ON DECISION

Subject: *Schieber v. Commissioner*, T.C. Memo. 2017-32
T.C. Docket No. 21690-14

Issue: Whether an interest in a defined benefit pension plan is an asset for purposes of applying the insolvency exclusion in I.R.C. § 108.

Discussion: Amounts that would be includible in gross income by reason of the discharge of indebtedness of a taxpayer may be excluded if the discharge occurs when the taxpayer is insolvent. Sec. 108(a)(1)(B). The amount of income excluded under this provision "shall not exceed the amount by which the taxpayer is insolvent." Sec. 108(a)(3). For this purpose, the term "insolvent" means "the excess of liabilities over the fair market value of assets." Sec. 108(d)(3).

In *Merkel v. Commissioner*, 109 T.C. 463 (1997), the Tax Court held that a certain liability was too contingent to be included in the meaning of the term liability under section 108(d)(3). In *Carlson v. Commissioner*, 116 T.C. 87 (2001), the court relied on *Merkel* in holding that an asset exempt from creditors under state law was included in the meaning of the term asset under section 108(d)(3). Both opinions cited to the underlying legislative history and concluded that the taxpayers' ability to pay an immediate tax on income was relevant in determining whether the liability or asset fell within the meaning of those terms in the statute. The court in each case measured the taxpayers' economic solvency and their ability to pay an immediate tax by considering the reality of the taxpayers' financial situations. In *Merkel*, that reality was reflected by a determination that it was unlikely the taxpayers would be called upon to pay the obligation. In *Carlson*, that reality was measured by the court's determination that including exempt assets more accurately reflects the taxpayer's economic situation.

In *Schieber*, the court held that the petitioners' interest in a pension plan was not an asset for purposes of the insolvency exclusion because it could not be converted into a lump-sum cash amount, sold, assigned, or borrowed against.¹ In support of its decision, the Tax Court stated that, the "test" in *Carlson* for whether something is an asset "is whether it gives the taxpayer the 'ability to pay an immediate tax on income' from the cancelled debt—not to pay the tax gradually over time." *Schieber* at *12.

The Tax Court in *Schieber* erred by taking language from the legislative history of section 108 that the court used in interpreting the statute in *Merkel* and *Carlson* and

¹ Whether an interest in the pension plan can be converted into a lump-sum cash amount, sold, assigned, or borrowed against is a question that the court concluded was not disputed by the Service in this case. The Service may dispute this premise in future cases.

turning that language into a threshold test not found in the statute itself. The phrase is merely part of the underlying legislative history that explains why Congress enacted the insolvency exclusion, to provide a “fresh start” to an insolvent taxpayer and require a reduction of tax attributes under section 108(b). See *Carlson, supra* at 101 (“the relevant committee reports intimate that the policy judgment underlying the insolvency exclusion serves a humanitarian purpose—to avoid burdening an insolvent debtor outside of bankruptcy with an immediate liability.”). The court in *Schieber* used this legislative history language to hold that something that falls within the plain meaning of the term asset (in this case, the right to a stream of payments over a taxpayer’s lifetime) is not considered an asset for purposes of section 108(d)(3). Furthermore, the court’s holding in *Schieber* is internally inconsistent because it does not consider even the current year’s distributions from a pension in the insolvency computation.

Accordingly, the Service will not follow *Schieber* in excluding assets from the definition of asset under section 108(d)(3) on the grounds that they cannot be converted into a lump-sum cash amount, sold, assigned or borrowed against.

Recommendation: Nonacquiescence.

/s/

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